JOINT ECONOMIC COMMITTEE

MINORITY

UNITED STATES CONGRESS

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Ranking Democrat

Unfinished Business

Bringing Economic Prosperity
to All Americans

November 1999

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Unfinished Business

For the first time in over a generation, an increasing number of Americans are enjoying economic prosperity. Unemployment is down, inflation is low and incomes for many are rising. The US economy is currently in its ninth consecutive year of economic growth, the nation's longest peace-time expansion. Yet, underlying this good news is a lot of unfinished business.

At First Glance

The economy has grown on average by more than 3 percent a year since 1991. Economic growth during the third quarter of 1999 was 4.8 percent. There are no signs that the economy will slow down, at least in the near term.

Unemployment is at its lowest rate since the early 1970s. The unemployment rate has been at or below 5 percent during each month since April 1997. During the first half of 1999, the unemployment rate averaged 4.3 percent, the lowest rate in more than 25 years. The unemployment rate in the United States is currently lower than in Japan and many European countries.

After 20 years of stagnation, real average weekly earnings have begun to rise. Weekly earnings did not begin to increase until well into the current economic recovery. Since 1996, real average weekly earnings have increased by 6 percent. Despite this recent increase, the *level* of real weekly earnings remains below its pre-1980 level.

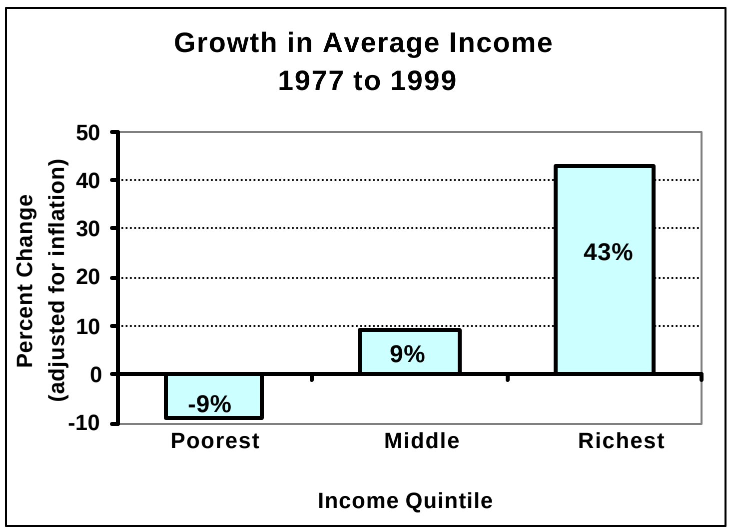
Inflation has fallen to its lowest rate in almost 30 years — despite continued declines in the unemployment rate. During the first half of 1999, inflation rose by an annual rate of 2.2 percent. Falling commodity prices, significant reductions in transactions costs and moderate business expenses have contributed to keeping prices low.

The economy has created 20 million jobs between 1992 and 1999. Almost all of those new jobs have been in the service sector. More than 90 percent of the new jobs created (18.4 million) were in the service sector and 1.8 million jobs were created in construction. Only 280,000 jobs were created in manufacturing. Manufacturing employment increased by 748,000 jobs between 1992 and May 1998. Nearly a half million manufacturing jobs have been lost since then, primarily due to increased imports and declining exports. The growing trade deficit has contributed to the shift in employment out of high-wage manufacturing jobs with benefits and into lower-wage service jobs without benefits.

Overall, there is much to celebrate in the current economic expansion. At the same time, not everyone in America has enjoyed the benefits of the prospering economy. The economy seems to be split into two groups — those who are able to share in the fruits of economy-wide growth, and those for whom it takes longer to realize the broader economic gains. Economic statistics based on national averages tend to camouflage the plight of this second group.

• The Widening Income Gap

The Center on Budget and Policy Priorities recently released a study entitled, "The Widening Income Gulf." The study is based on data released this summer by the Congressional Budget Office[1]. The following are some of the report's conclusions:



- After adjusting for taxes (and the Earned Income Tax Credit), the top 20 percent of US households will have experienced a 43 percent increase in average income from 1977 to the end of 1999, while the average income of the lowest 20 percent will have witnessed a 9 percent ***decline*.**
- The *increase* in income of the top one percent from 1977 to 1999 will equal the *total* income of the lowest 20 percent this year.
- The richest one percent of Americans — 2.7 million people — will take home as much after-tax income as the lowest 38 percent — or 100 million people — ***combined***.
- In 1977, the top one percent of Americans received 7.3 percent of all national after-tax income; in 1999 it is expected to be 12.9 percent.
- On average, the richest one percent of households will pay a smaller percentage of their 1999 income in taxes than they would have under 1977 tax rates. This amounts to an average saving of $40,000 per household.

The foundations for this disparity were laid by the inequitable policies of the 1980s. We have made some strides at addressing these problems, but not enough. Most of the large income growth for the top 20 percent occurred from 1977 to 1989,when their

1 The CBO data begins with 1977 and ends with 1999 projections.

average after-tax income increased by 33 percent, compared to 7 percent from 1989 to 1999.

Comparing the increase in income *before* taxes to the increase *after* taxes for the richest Americans illustrates the perverse impact of federal tax policy over the last 20 years. For example, the before-tax increase in average income of the top one percent of households is 96 percent between 1977 and 1999. But their *after*-tax income is expected to grow by 115 percent. All this is expected to occur while the poorest fifth of households experience a ***decline*** in their average income***.***

• Regional Disparities

There is evidence that there is a regional component to the widening income gap. Per capita income growth across the nation averaged 4.5 percent annually between 1991 and 1997. Despite this strong growth, approximately 500 counties — almost 16 percent of all counties — experienced no growth in average annual per capita income. By contrast, the remaining 2,580 counties experienced an average per capita income growth of 5½ percent annually during the same period. The low per capita income growth ("low growth ") counties constituted more than 24 million people, or roughly 10 percent of the nation's total population. These counties tended to have a heavier reliance on farming and mining than the other counties. Despite the recent pick-up in the California economy, 29 percent of all Western counties experienced almost no growth in per capita income.

As might be expected, the low growth counties had a higher incidence of poverty, with almost 700,000 families in these counties facing poverty in 1997. The low growth counties also had lower high school and college graduation rates, which are key to promoting improvements in income. The low growth counties included large population centers such as Los Angeles, Fresno, Santa Barbara, Queens and Honolulu.

In addition to per capita income growth, there are regional differences in unemployment rates. In 1998, 389 counties — 13 percent of all counties — experienced unemployment rates of 8 percent or more, close to twice the national average. A little more than half of those counties — 187 of them — experienced unemployment at or above 10 percent. Less than one third of the counties which experienced low per capita income growth also had high unemployment rates.

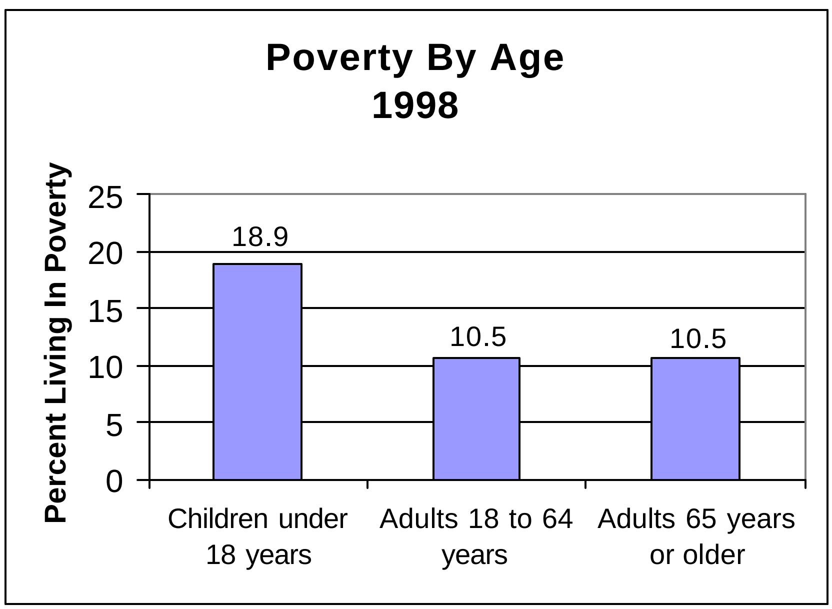
These "high unemployment counties" constituted 20 million people, or 7 percent of the national workforce. A sizable number, but not all, of high unemployment counties were major population centers. These included two of the five New York boroughs. These counties were not regionally concentrated: 39 states had at least one high unemployment county. Yet some states do have a disproportionate number of high unemployment counties. High unemployment counties tend to correlate with lower educational achievement and a persistence of high unemployment.

One of the factors behind the declines in living standards for those on the lower end of the income distribution has been the erosion, and in some cases even elimination, of several government programs. Examples include welfare reform and the erosion in the real value of the minimum wage.

- **High Rates of Child Poverty**

A significant number of Americans – particularly children – live in poverty, despite recent improvements in the overall economy. Although the total poverty rate declined for the fifth year in a row, **last year 34.5 million Americans — 12.7 percent of the country's population — lived below the poverty line.** Poverty continues to disproportionately affect minorities: 26.1 percent of African-Americans and 25.6 percent of Hispanics lived below the poverty line, compared to only 10.5 percent of whites in1998.[2] The South and the West had notably higher poverty rates (13.7 percent and 14 percent respectively) than the Northeast (12.3 percent) and the Midwest (10.3 percent).

Children were the worst off, as one in five lived in poverty – 18.9 percent of children under 18 years old, and 20.6 percent of children under 6 living with their families did not receive enough income to meet basic needs. The Children's Defense Fund estimates that **by the time they turn 16 years old, one in three American children will have spent at least one year in poverty** (*Poverty Matters*, 1998). For a single parent with two children, the poverty line is $13,133. It is $11,235 for a parent with one child.



Source: Census Bureau.

2 The number of white people in poverty remains greater than African-Americans and Hispanics in poverty.

In addition to its social impacts, child poverty has profound economic impacts into the future. Children raised in poverty are more likely to have poor health, commit crimes, drop out of high school, have lower test scores, and lower lifetime earnings.

• The Aftermath of Welfare Reform

A key goal of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 — welfare reform — was to "end the dependence of needy parents on government benefits." In January 1993, 14.1 million people were on welfare. By March 1999 this figure had fallen to 7.3 million — a 48 percent drop. An August 1999 report by the Council of Economic Advisors attributes nearly 36 percent of this decline to the unusually strong labor market, and 10 percent to the increase in the minimum wage in 1997. A significant minority of those leaving welfare have not married or moved in with relatives, and have essentially "disappeared" from the official statistics. The General Accounting Office reviewed all the broad state studies on former welfare recipients (17 states) and found that significant numbers of families could not be located. Even those studies that used 'administrative data' (matching families to other records including employment and other public assistance) missed 8 percent to 18 percent of families.

There is some evidence which suggests that most of those people leaving welfare are working. The Urban Institute found that 61 percent of former welfare recipients were working in 1997, a rate that was higher than that for similar low-income mothers who were not on welfare.

One of the most troubling early findings is that **even among the early group of welfare leavers – whom many researchers felt would be the easiest to employ – staying off public assistance has proven to be difficult.** The Urban Institute's survey of those who left welfare during 1995 and 1997 found that 29 percent returned to the welfare rolls. Meanwhile, a significant portion of those who managed to stay off welfare were receiving other benefits (food stamps, and housing assistance).

Many researchers have cautioned that the most difficult-to-assist welfare recipients are still on welfare rolls and that a notable slow-down in the decline of welfare recipients should be expected over the coming years. A 1997 Urban Institute study found that more than half of welfare recipients in 1991 "experienced a serious form of at least one potential barrier [to employment]". Although the law does allow for 20 percent of a state's welfare population to be exempt from the five year time limit on benefits, this figure can not cover all former welfare recipients with disabilities, low basic skills, substance abuse, and domestic violence.

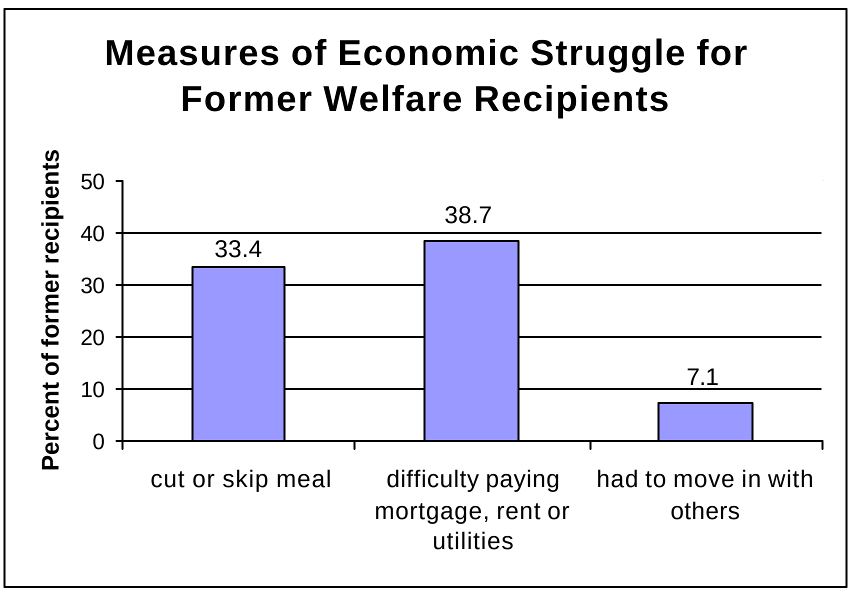
Additional data show that across the nation, the income of the poorest of the poor is declining again after gains in the mid-1990s – at least partially due to

the huge drop in the number of welfare recipients. The recent Center on Budget and Policy Priorities study found that the average income of the poorest 20 percent of single mothers with children improved by almost 14 percent between 1993 and 1995, but ***declined*** by almost 7 percent from 1995 to 1997, during which time welfare reform was being fully implemented.

Another significant problem facing this group is that **many former welfare recipients still can not afford health coverage.** The Urban Institute found that 41 percent of adults and 25 percent of children who used to be on welfare did not have public or private health insurance. Given the high cost of medical care, families without health coverage are unlikely to be able to remain off welfare assistance.

A significant minority of former welfare recipients had more difficulty getting enough food and paying utilities than other families at the same income level. The Urban Institute study of mothers who left welfare during 1995 to 1997 found that one third had to cut the size of a meal or skip a meal because there wasn't enough food, compared to only 24.7 percent of other mothers with similar income levels. Even more, 38.7 percent, had difficulty paying mortgage, rent, or utility bills, versus only 28.9 percent of other mothers with similar income levels.

• The Need for More Child Care

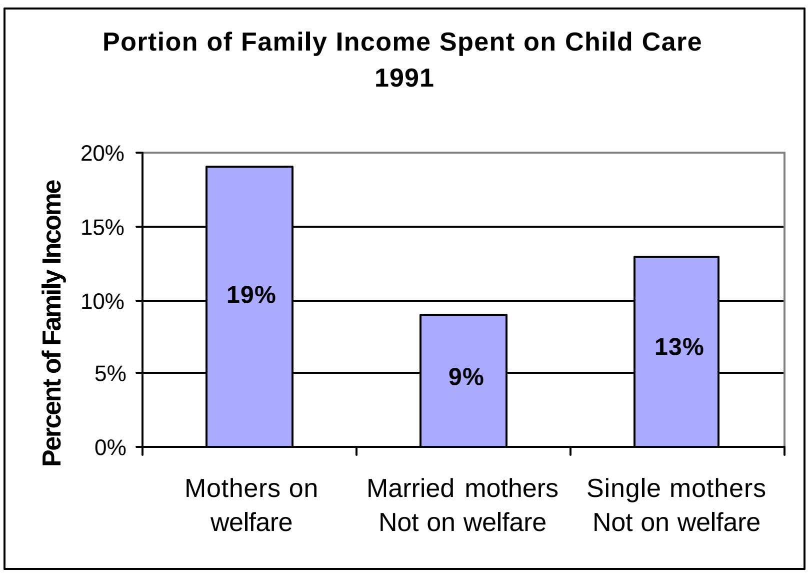


Source: Urban Institute.

The lack of adequate funding for child care will exacerbate the difficulties facing those who have recently left welfare. The 1996 welfare reform legislation combined all funds for child care into a single block grant, which was then capped. Some researchers have raised concerns that welfare reform is structured to increase the need for child care (by requiring that parents work) at a time when many states were already having difficulty serving all the low-income parents needing child care assistance, and limiting funds for that purpose (Women's Institute for Policy Studies, *Issue Brief 6*, May 6, 1997).

The importance of quality child care for low-income workers can not be underestimated. Analysis of federal data by the Women's Institute for Policy Studies found that mothers on welfare spent 19 percent of their income on child care, a significantly higher portion than non-welfare single mothers (13 percent). Adjusting poverty for food stamps and Women, Infant and Children (WIC) assistance, the Institute still found that 52 percent of welfare mothers paying child care lived in poverty, but if their child care costs were completely subsidized, only 35 percent would still be living under the poverty threshold. The heavy burden child care costs place on low income workers is a key factor to their high turnover rate and departure from the workforce.

- **The Declining Minimum Wage**



Source: Womens Institute for Policy Studies.

During the past two decades, the ***real*** value of the minimum wage has been falling. This has hampered the ability of those at the lower end of the socioeconomic scale to fully share in the benefits of the recent economic prosperity. This erosion continues despite moderate increases in other wage and salary indices.

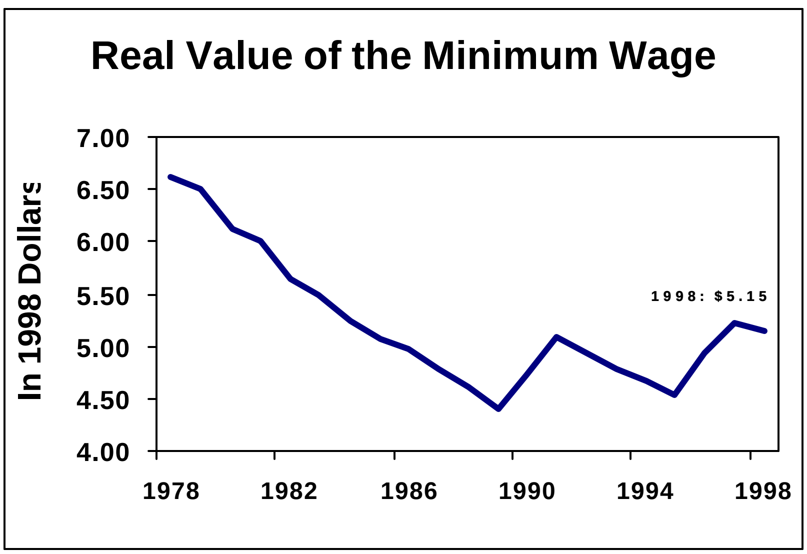
Part of the continuous erosion in the minimum wage can be explained by its legislatively-mandated structure. The minimum wage can only be adjusted by an act of Congress. Thus, the minimum wage, by its very nature, is reactive and is always trying to "catch up" to changes in prices and other wages.

The minimum wage was first instituted in 1938 to help ensure "maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers." The minimum wage is one of the country's oldest income policy tools. In 1998, 4.4 million people earned the minimum wage, which is currently set at $5.15.

Most employees receiving the minimum wage work in fast food restaurants, retail establishments, and low-end service jobs (such as commercial housekeeping). More than half of those workers earning the minimum wage are employed in retail trade. Another 25 percent of minimum wage workers are employed in agriculture and 6 percent in the public sector. Women comprise almost two-thirds of minimum wage workers and minorities are disproportionately more likely to earn the minimum wage.

After increases in the 1950s and early 1960s, the real value of the minimum wage peaked in 1968, fluctuated during the 1970s, and has, for the most part, been declining since then. The current minimum wage, $5.15, is similar to its real value in 1983 and 1984, and remains ***below*** its real value during the 1960s and 1970s. Over the last 20 years, the real value of the minimum wage has fallen by 22 percent. By contrast, the real average wage for all hourly workers has declined by 10 percent, or less than half that amount. Workers earning the minimum wage have been experiencing a real decline in their living standards — earning less and less for the same amount of work, and falling farther and farther behind.

The minimum wage does *not* guarantee a family income above the poverty level. Working full-time at the minimum wage, an individual would earn a gross salary of $10,300, without taxes and benefits. After taking taxes into account — subtracting the payroll tax and adding back the Earned Income Tax Credit — net income would be $10,912. This is lower than the national poverty rate for a family of one adult and one child ($11,235), one adult, two children ($13,133) and two adults, one child ($13,120). In order for an adult working full-time to earn enough to meet the federal poverty guideline for a family of two, the minimum wage would need to be set at $5.62. For a single parent with two children, the minimum wage would need to be at least $6.57.



Source: Bureau of Labor Statistics.

The 1996 and 1997 increases in the minimum wage have been accompanied by falling unemployment rates for teenagers and minorities, those groups most likely affected by the minimum wage. Between 1996 and the first half of 1999, the unemployment rate for teenagers fell from 16.7 to 13.5 percent, the Africa-American unemployment rate fell from 10.5 to 7.3 percent and the unemployment rate for other minorities fell from 8.9 to 6.8 percent. Similar patterns have also occurred in states which have recently raised their minimum wage above the federal level. With respect to living wage ordinances, 2 years following the establishment of a living wage in Baltimore, the costs of city contracts declined, wages increased, and unemployment declined.

Recent evidence flies in the face of the claims that increases in the minimum wage necessarily lead to increased unemployment. Three issues must be considered when estimating the impact of an increase in the minimum wage on employment: the prevailing minimum wage, the size of the increase and the economic environment against which the increase is taking place. As the US economy enters one of it longest expansions in recent history, there are signs of labor shortages in many parts of the country. Raising the minimum wage during a period of a tight labor market can result in more employment. Firms may be more willing to train those workers employed at the minimum wage, thereby increasing productivity. In addition, as people are being moved off the welfare rolls and brought into the workforce, and other benefits are being reduced, it is becoming increasingly important that full-time employment brings enough earnings to purchase basic food, shelter, and health care.

- **The Growing Number of People Without Health Insurance**[3]

Forty-four million non-elderly Americans did not have health insurance in 1998, almost 6 million more than when the current economic expansion began in 1992.

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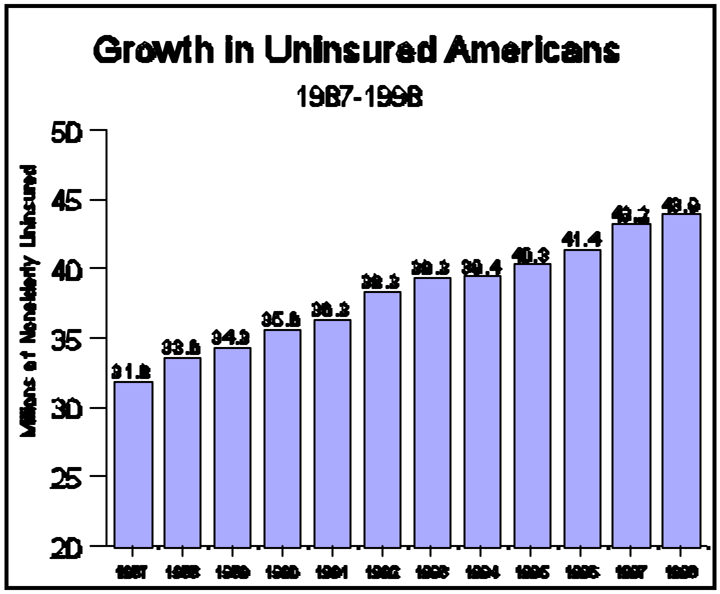
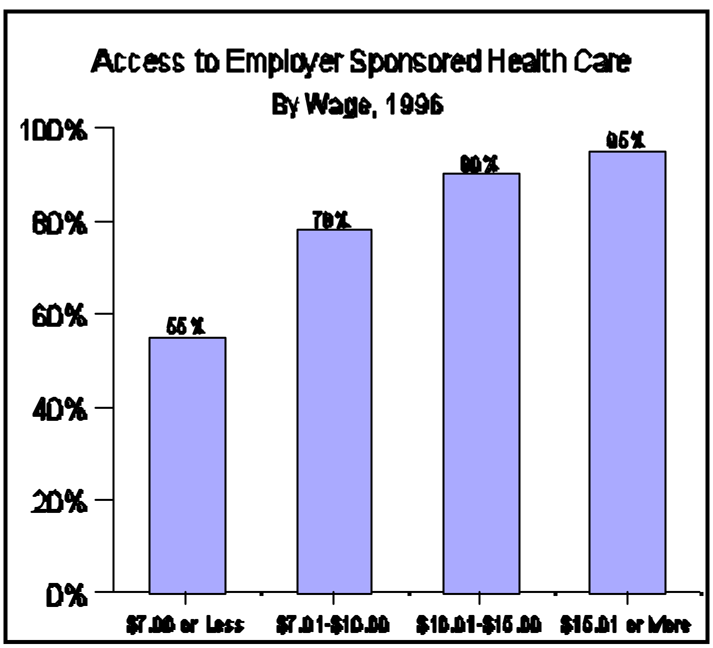
3 This section relies heavily on three sources: Hewitt Associates for The Henry J. Kaiser Foundation, *Retiree Health Coverage: Recent Trends and Employer Perspectives on Future Benefits*, October, 1999; The Kaiser Commission on Medicaid and the Uninsured, *Uninsured in America, A Chart Book*, June 1998; The Kaiser Commission on Medicaid and the Uninsured, *Health Insurance Coverage of Low Wage Workers*, June 1998.

The US system of health insurance is one of the few in the world that is structured around the workplace. In recent years, small businesses have accounted for more than three-quarters of the job expansion. Yet, between 1996 and 1998, the percentage of small business employees with employer sponsored health coverage dropped from 52 percent to 47 percent. In 1998, only 54 percent of small firms offered health coverage, down from 59 percent in 1996.



Source: Kaiser Commission, *Uninsured in America,* June, 1998; *1998 Health Insurance Coverage.*

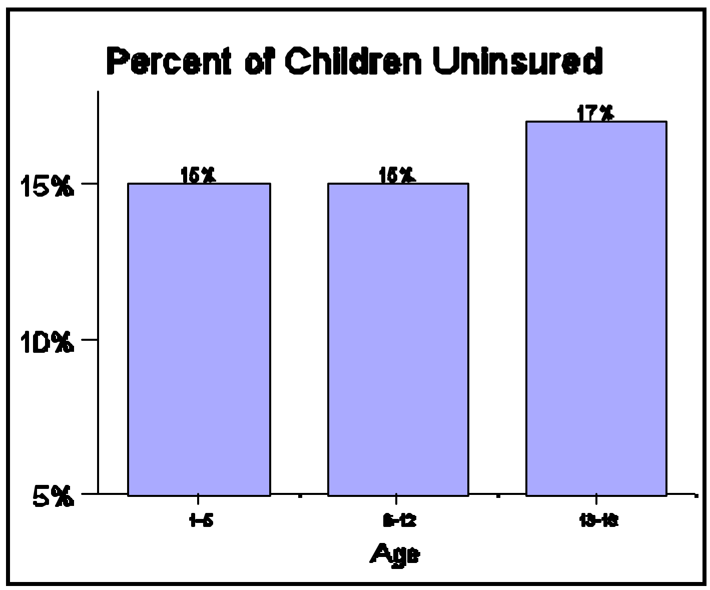
Currently, 70 percent of the uninsured are full-time workers or dependents of full-time workers. Unfortunately, the disparity in coverage between low-wage workers and high-wage workers has widened as coverage for low-wage workers has rapidly deteriorated. Between 1987 and 1996, health insurance coverage rates for low-wage workers fell from 54 percent to 42 percent at the same time that coverage for the highest paid increased from 87 percent to 90 percent. Most recent data show that only 55 percent of low-wage workers ($7 per hour or less) have access to job-based coverage, compared to 95 percent of higher-wage workers.



Source: Cooper and Schone, *More Offers, Fewer Takers for Employment Based Health Insurance*: 1987-1996, Health Affairs (November/December, 1997)

Employer-provided health benefits are the leading source of supplemental coverage for Medicare beneficiaries and are the largest source for supplemental prescription drug coverage. However, employer-based coverage is on the decline, with many large companies dropping coverage and fewer new companies adding it. A number of trends have surfaced in recent years: fewer large companies offer post-retirement health benefits; financial caps have been frequently placed on employers' contributions, eligibility requirements have tightened; and more employers have offered Medicare managed care plans. A recent study shows that between 1991 and 1998, coverage of health plans provided by large employers for retirees above the age of 65 years old declined by 13 percentage points. For those retirees younger than 65, coverage has declined by 12 percentage points. In addition, the percent of companies that require retiree contributions rose from 73 percent in 1991 to 92 percent in 1998.

Eleven million children, or one out of every ten children in America, are currently not covered by health insurance. Two-thirds of uninsured children live in families with two parents and 85 percent live in families where at least one parent is working full-time. Under Medicaid, states are required to cover children under the age of 14 living in poverty. This has helped young children, but teenagers have fallen through the cracks. Teenagers now make up a disproportionately high percentage of children who are uninsured. Seventeen percent of teenagers under the age of 19 are uninsured, and 15 percent of children between the age of 1 and 12 are uninsured. In total, 15.6 percent of children are uninsured, up from 14 percent in 1995.



Source: Kaiser Commission, *1998 Health Insurance Coverage.*

In 1997, Congress passed the Children Health Insurance Program aimed at providing health care coverage to more children. Ironically, the number of uninsured children has grown since the program began, leading many to consider the program a failure.

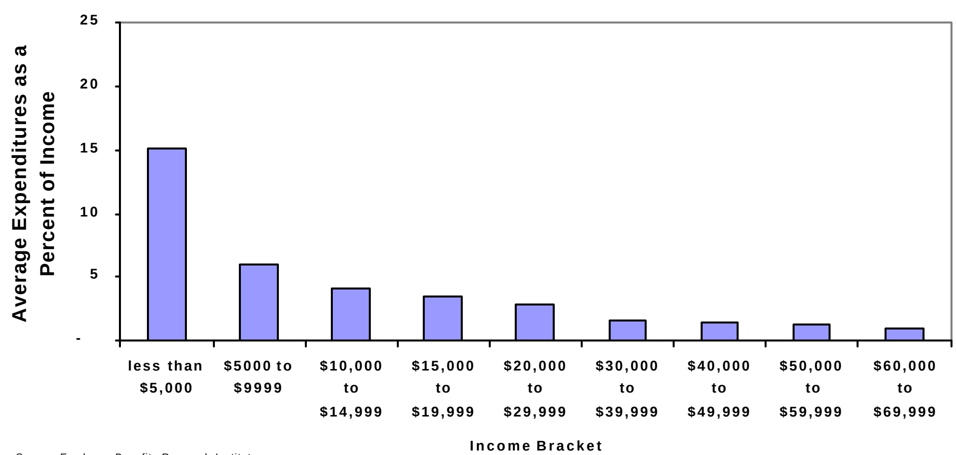
• The High Cost of Medication

Concerns about rising prescription drug costs, the desire to enable more seniors to take advantage of new effective medications, and arguments that proper use of medications can decrease the reliance on other, more expensive treatments have led to various initiatives to incorporate a prescription benefit into the Medicare program.

Since 1980, drug expenditures have grown in the double digits, far more than the growth in total health care expenditures. In 1997, drug expenditures grew by 14 percent, almost three times the growth rate of total national health care expenditures, hospital service expenditures and physician service expenditures.[4] At the same time, profit rates for the drug industry reached close to 20 percent, four times larger than the average profit rates for the Fortune 500 companies.

Most of the growth in drug expenditures can be traced to a significant increase in volume, mix and availability. As the costs of prescriptions escalated and an expanded number of new medicines provided cost-effective alternatives to other medical therapies, private health plans began covering an increasing portion of prescription drug payments during the 1990s.

Drug Expenditures of the Elderly by Income in 1994-1995



Source: Employee Benefits Research Institute

Yet those who rely the most on prescription drugs — the elderly — do not have any comprehensive prescription drug coverage as a group. Although they comprise only 12 percent of the population, the elderly account for one third of all prescription drug use.[5] However, almost 14 million elderly – approximately one-third of the 38 million people enrolled in Medicare in 1997 – had *no* prescription drug coverage at all. An additional 4 million people voluntarily paid more and received limited prescription coverage. The rest were covered either through Medicaid or private employer-based plans.

Prescription drug costs have become a significant financial burden on the elderly, as drugs are the single largest out-of-pocket medical expense for seniors, many of whom have moderate incomes. In 1994 and 1995, 76 percent of seniors had incomes below $30,000 and the average senior paid $558 for prescriptions. This compared to an average of $355 spent by 55 to 64 year-olds during the same period. In fact, a 1993

4 Employee Benefits Research Institute, Issue Brief 208, April 1999.

5 *Ibid.*

survey found that one in eight seniors reported having to chose between medicine and food at some point during the year.[6]

Additionally, HMOs, hospitals and other large purchasers are able to negotiate lower drug prices than uninsured individuals. Consequently, Medicare beneficiaries without supplemental private insurance for prescription drugs spend twice as much on prescription drugs as their counterparts with private insurance.[7] In fact, seniors without prescription drug coverage pay the highest prices for medications than any other group.

It is difficult to precisely predict all the potential impacts of the various prescription drug proposals. Some studies have shown that drugs can be used as effective substitutes for other kinds of treatment.[8] For example, proper use of medication can be expected to decrease hospital and nursing home costs.[9] According to the General Accounting Office, Medicaid's automated drug utilization system reduced adverse drug reactions and saved more than $30 million in five states.

Consequently, adding a prescription drug benefit to Medicare might be expected to increase prescription drug usage but not necessarily raise overall medical costs. Financial incentives to drug manufacturers to continue searching for new medicines which might substitute for expensive existing drugs and for in-patient care will continue. In the end, a prescription drug benefit might result in healthier seniors, and curb, or even bring down, overall medical costs.

Conclusion

The economy is in its best shape in years, yet some Americans are not enjoying the prosperity. There remains quite a lot of unfinished business to attend to in order to raise living standards of all Americans.

One immediate way to address the growing income gap is to strengthen the safety net for those who might not be enjoying the benefits of the current economic expansion. It is important to raise the minimum wage in order to correct for the 20 year erosion in its value. We must raise everyone, especially children, out of poverty. We need to provide more child care and better health insurance coverage for all who need it. We also must extend health insurance to include coverage of prescription medications, a critical part of medical care.

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6 *American Pharmacy,* October, 1992; HCFA Office of Strategic Planning, Data from the Current Beneficiary Survey, cited in staff documents, Medicare Commission; Department of Health and Human Services, unpublished data; Committee on Government Reform and Oversight, US House of Representatives, Minority Staff Report, "Prescription Drug Pricing in the United States: Drug Companies Profit at the Expense of Older Americans," October 20, 1998.

7 Rogowski, *The Gerontologist* 37:4 (August 1997).

8 See for example, the Employee Benefit Research Institute.

9 See *New England Journal of Medicine*, March 4, 1999.

Stemming any further widening in the income gap, let alone reducing it, does not necessarily have to mean taking wealth away from the rich. It can be done by devoting more of the recent economic gains to those people whose incomes have not been growing as much.

The United States is experiencing an unprecedented period of economic prosperity. Unemployment is at a historic low and there are no signs of a resurgence of inflation. But as good as this story is, it is not complete. Economic prosperity has not yet come to millions in our society, and for most it has come following a period of prolonged economic stagnation. The challenge before the nation is to both ensure the continuation of this economic prosperity and to aim at sharing its benefits more widely with all Americans.